No. 12481

In the United States Court of Appeals for the Ninth Circuit

FAY J. HANSEN, Appellant

v.

ERNEST A. JONSON, Receiver of Vita Pakt Associates, Inc., an Insolvent Corporation, and R. C. NICHOLSON, Trustee of the Estate of Fay J. Hansen, Bankrupt, Appellee.

OPENING BRIEF OF APPELLANT

APPEAL FROM THE UNITED STATES DISTRICT COURT, FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

ALEXANDER WILEY,
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STATEMENT SHOWING JURISDICTION

Sec. 2(7) of the U. S. Bankruptcy Act (11 U.S.C.A., Sec. 11(7) confers upon courts of bankruptcy the power to determine controversies in relation to the estates of bankrupts.

Sec. 2(10) of said Act gives to the district judges power to review matters certified to said courts by referees.

Sec. 2(11) of said Act invests said courts of bank-

ruptcy with jurisdiction to determine all claims of bankrupts to their exemptions.

Sec. 24 of the U. S. Bankruptcy Act (11 U.S.C.A., Sec. 47) vests in the United States Courts of Appeal appellate jurisdiction from the courts of bankruptcy in proceedings in bankruptcy and controversies arising in proceedings in bankruptcy.

Bankrupt filed his petition with the referee for the issuance of an order directed to the trustee and the receiver of Vita-Pakt Associates, Inc., to show cause why transfers made by bankrupt of all his property within one week prior to his adjudication should not be adjudged void. All the property in controversy before the referee, district judge and this court was in the possession of the bankrupt at the time of his adjudication in bankruptcy, and since said time remained in the possession of the trustee in bankruptcy until same was sold by the trustee.

The trustee joined the bankrupt in alleging said transfers were void and fraudulent and should be set aside. The referee set aside said transfers, adjudged them void, and awarded to bankrupt his statutory exemptions out of the proceeds of the sale of said assets. The district court reversed the referee's order and denied bankrupt all exemptions claimed.

This case unquestionably involves a controversy arising in proceedings in bankruptcy.

STATEMENT OF THE CASE

Fay Hansen, appellant herein, and Paul Schafer were copartners engaged in processing and selling orange juice. Schafer surrendered his interests to Hansen. Hansen incorporated Vita-Pakt Associates, Inc., and subscribed for 530 shares of stock therein in return for the transfer to the corporation of all assets of the partnership, subject to its liabilities. Hansen and his wife were directors of said corporation. Hansen sold 519 shares of stock in said corporation for $51,900.00 and gave away 96 shares of stock. Said sum was deposited in the bank account of the corporation. Only one share of stock was actually issued to Hansen, as it was the intention of Hansen to take care of the bookkeeping details of the issuance and transfer of the stock at some later date. The corporation allotted 530 shares of stock to Hansen, and 260 shares were allotted for the purposes of sale by the corporation. Hansen used $5,897.00 of the money in the bank account of the corporation in the belief that such funds constituted proceeds of the sale of his own stock. Some $10,000.00 of said funds were used by Hansen to pay debts of the partnership, and the money owing to Schafer for his interest in the partnership. The stockholders of the corporation employed an accountant and attorney, who accused Hansen of misappropriating corporation funds and of selling stock without a permit from the state and thus committing a crime. They insisted that he turn over to the

corporation all the property of every kind which he possessed, and told him if he did this the stockholders would feel more kindly toward him and would not be apt to prosecute him. To avoid criminal prosecution he and his wife transferred to the corporation all the property of every kind which they owned. One week thereafter Hansen was adjudicated bankrupt on his voluntary petition on August 5, 1948. In his schedules in bankruptcy he recited that he had within a week prior thereto signed transfers of all the property he owned—consisting of an equity in his home, an automobile, his household furniture and a vacant lot—to Vita-Pakt Associates, Inc.; that such transfers had been obtained from him by extortion and duress and threats of criminal prosecution, and were void.

On August 31, 1948, the trustee signed and filed his report on exemptions in which he allowed to bankrupt the exemptions claimed, to-wit: $4,000.00 interest in his home as homestead exemption; $500.00 interest in household furniture; and $250.00 lieu exemption, as provided by the statutes of the State of Washington, in his equity in his automobile. No exceptions to said report on exemptions having been filed within ten days, as required by General Order No. 17(2) in Bankruptcy, on October 20, 1948, at the trustee's request the referee in bankruptcy entered an order approving said report on exemptions.

Thereafter Hansen petitioned the referee in bank-

ruptcy to issue an order citing into court the trustee in bankruptcy and the receiver of Vita-Pakt Associates, Inc., to show cause why such transfers should not be adjudged void. The trustee joined in bankrupt's petition. The receiver denied said transfers were void, and claimed an equitable lien upon the property transferred; and alleged that the property transferred had been paid for in part with funds belonging to said corporation. After several days of trial on the issues above set forth the referee in bankruptcy entered an order adjudging said transfers made by bankrupt to be void. Both the trustee and receiver filed petitions for review of said order.

After the referee had given his memorandum decision, but before said order was entered, the trustee in open court orally, and without submitting any written petition therefor, requested the referee to set aside his previous order approving trustee's report on exemptions, and disallow said exemptions. The referee orally announced his denial of said petition.

After the entering of said order by the referee, and after petitions for review of same had been filed, at the request of the trustee the referee entered a supplemental order denying trustee's petition to set aside the Order Approving Trustee's Report of Exemptions.

No petition for the review of said supplemental order has ever been filed by anyone.

The district court reversed the order of the referee

and disallowed bankrupt's claim of exemptions.

From that judgment of the district court this appeal is taken.

SPECIFICATIONS OF ERROR

I. The district court erred in reversing the order of the referee and disallowing to bankrupt his exemptions.

II. The district court erred in awarding any funds to the receiver.

III. The district court erred in its finding of fact that all moneys received from the sale of corporation stock was the property of the corporation, and that Hansen had misappropriated any funds belonging to the corporation.

IV. The district court erred in finding that Hansen had voluntarily made the transfers of property to the corporation, and said transfers were not secured by threats of criminal prosecution.

V. The district court erred in finding that said transfers were not made as security, and did not constitute a general assignment for creditors.

VI. The district court erred in concluding that the sum of $5.897.00 constituted a first and prior lien against proceeds of the sale of bankrupt's property.

VII. The district court erred in concluding that the referee should have vacated the order approving

allowance of bankrupt's exemptions and in disallowing said exemptions.

The question involved in this appeal is the same question before the District Court: Was the referee's order clearly erroneous?

The questions involved in this appeal are the same questions which were before the district court on the hearing of the petitions for review of the order of the referee in bankruptcy; and appellant believes this court should affirm the order of the referee unless it is clearly erroneous.

We quote from the opinion in the case of *Morris Plan Industrial Bank v. Henderson,* 2 Cir., 131 F. 2d 975, 977:

> "We therefore hold that the question is the same in this court as it was in the district court."

In the case of *Smith v. Federal Land Bank of Berkeley,* 9 Cir., 150 F. 2d 318, 321, the court states:

> "We think under these rules we should examine findings of both the district court and conciliation commissioner for clear error only, on an appeal such as the instant one from a judgment of the district court setting aside an order of the conciliation commissioner."

The court in the case of *Mergenthaler v. Dailey,* 2 Cir., 136 F. 2d 182, 184, par. (2), stated clearly:

> **"We have the same duty as the district court to accept the referee's findings unless they are clearly erroneous."**

We cite from the opinion in *Phillips v. Baker,* 5 Cir. 165 F. 2d 578, 581, par. (1):

> "Before proceeding to deal with the separate classes of appeals, a word or two of general application will be in order. The first and most important is that in dealing with the questions presented for our decision, we are not dealing with the ordinary situation of an appeal from findings of fact of a district judge, which under rule 52(a), Federal Rules of Civil Procedure, 28 U.S.C.A. following section 723c 'shall not be set aside unless clearly erroneous.' We are, on the contrary, dealing with findings made by the district judge, adverse to those of the referee, in respect to matters primarily remitted for decision to the referee and as to which it is provided that 'the judge shall accept his findings of fact unless clearly erroneous.' *Under that rule 'we have the same duty as the district court to accept the referee's findings, unless they are clearly erroneous.'* Under that rule we, of course, take into consideration the fact that the district judge has refused to accept the referee's findings. But we do so not in determining whether the district judge's findings are clearly erroneous. for that is not the matter before us. We do it in determining whether the referee's findings are, and we do this with the clearest recognition that the duty to determine whether the referee's findings 'must be accepted' and whether the district judge has erred in not accepting them is not the district judge's but ours." (Italics ours)

I

District Court Erred in Reversing the Order of the Referee and in Disallowing Bankrupt's Exemptions

1. Introduction:

We know of no more appropriate introduction descriptive of the nature of these proceedings than to quote from the decision of the district judge, District Court of Georgia, in the case of *In re Talbot,* 116 Fed. 417, in which he held that a bankrupt might claim his exemptions allowed by the laws of Georgia from the proceeds of property which he had assigned for the benefit of creditors, after such property had been recovered by his trustee:

> "This is a very strenuous effort to defeat the application of the bankrupt for homestead, BUT IT IS BASED UPON A CARDINAL MISCONCEPTION OF THE DUTY OF THE COURT IN SETTING ASIDE SUCH EXEMPTIONS. The misconception is that the bankruptcy law and homestead law of the state both relating to exemptions are construed by counsel for objectors with the utmost strictness and narrowness, WHEREAS, A FUNDAMENTAL PRINCIPLE WITH REGARD TO JUDICIAL DETERMINATIONS OF APPLICATIONS FOR EXEMPTIONS IS THAT THEY SHALL BE CONSTRUED WITH ALL THE LIBERALITY PROPER AND POSSIBLE UNDER THE CIRCUMSTANCES."

In the very court from which this appeal is taken,

in the case of *In re McFarland,* 49 Fed. 2d, 342, 343, Judge Neterer said:

> "The administration of bankruptcy laws must be liberally construed, and not by strict interpretation deprive the unfortunate of the benefits permitted by wise and humane public policy."

The Supreme Court of the State of Washington in the case of *In re Poli's Estate,* 27 Wash. 2d, 670, 674, 179 P. 2d 704, 706, stated:

> "We have consistently held that 'Homestead and exemption laws are favored in the law and are to be liberally construed'."

In the case of *Hills v. Joseph,* 9 Cir., 229 Fed. 865, 869, this court declared:

> "The rule of construction applicable to exemption statutes is the most liberal known to the law. As said in 18 Cyc. at page 1380:
>
> 'By all but universal rule the statutes which create or give the right of exemption to a debtor are held subject to the rule of liberal construction. Indeed it would be more proper to say that they are generally SUBJECT TO THE MOST LIBERAL CONSTRUCTION WHICH THE COURTS CAN POSSIBLY GIVE THEM, the courts taking the ground that since the statutes have a beneficial object, their first duty is to see that this object is accomplished'."

In 1 Collier on Bankruptcy, 14 Ed., at page 796, it is stated:

> "As we have seen, it has long been the policy

> of Congress to give effect to state exemption laws. These exemption laws reflect the interest of the state in protecting its citizens from pauperism and securing to them some means of subsistence even in times of financial difficulty. In accordance with this philosophy, *it is therefore well settled that the provisions of the bankruptcy act and state laws in regard to exemptions should receive a liberal, rather than a narrow or technical construction.*"

In the case of *Smith v. Thompson,* 8 Cir., 213 Fed. 335, 336, Judge Hook said:

> "In every court the administration of an exemption law should comport with the beneficent spirit that prompted its enactment. A court of equity especially should not attempt to defeat the exemption by niceties in practice. It should be helpful to those whose condition requires them to invoke it."

With this background for our argument, we respectfully request the court to reverse the judgment of the district court, and affirm the judgment of the referee by allowing to the bankrupt the exemptions provided by the laws of the State of Washington and the National Bankruptcy Act.

2. The Referee's Findings of Fact should have been accepted by the District Judge.

We cite from No. 47 of General Orders in Bankruptcy adopted by the Supreme Court of the United States (11 U.S.C.A. foll. Sec. 53):

> "Unless otherwise directed in the order of

> reference the report of a referee or of a special master shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact unless clearly erroneous."

A most cursory examination of the opinion of the district court (Tr. 257) makes it apparent that the said court entirely mistook his province and his duty to affirm the referee unless the referee's order was clearly erroneous. Nowhere in said opinion does the court even venture the statement that any specific findings of fact made by the referee is erroneous in any particular. He merely states that "My conclusions are quite opposite to the conclusions of the referee."

Characteristic of many similar decisions is the holding in the case of *Equitable Life Assurance Society v. Deutschle,* 8 Cir., 132 F. 2d 525. We quote from p. 526, par. 1:

> "It is settled by numerous authorities that when the findings of a reference in bankruptcy are supported by substantial evidence they are not 'clearly erroneous' within the meaning of General Order 47, 11 U.S.C.A. following section 53, and that they will not be disturbed on appeal."

In the Conclusions of Law of the district court (Tr. 71) the court does not point out any specific finding of fact of the referee as being clearly erroneous, but concludes that the findings of fact of the referee "to the extent that the same are inconsistent with the findings

of fact hereinabove made, are not supported by the evidence and are clearly erroneous." Such a general conclusion of law exhibits an intent on the part of the court to arrive at his own conclusions upon the record of the proceedings before the referee, and upon superficial examination of some of the witnesses on some of the facts involved, even though every finding of fact made by the referee is amply supported by the evidence. We believe such practice is contrary to the requirements of General Order in Bankruptcy No. 47.

3. On the merits of the controversy bankrupt is entitled to the exemptions allowed to him by the Referee in Bankruptcy.

A. No party to these proceedings has ever disputed the fact that the exemptions allowed to bankrupt by the referee are in extent and amount those fixed by the general exemption laws of the State of Washington.

B. The district judge in his oral decision (Tr. 257) passes lightly over the rights of exemption given to impoverished debtors by the laws of the State of Washington, which rights are generally so jealously guarded by all courts. He states bankrupt obtained $4,500.00 by deceit, which sum went into the purchase of bankrupt's home; and says that "It is difficult for me to understand that justice, equity or law could be in accord with his keeping the fruits of such fraud." For the sake of argument, if we admit that the district court

was correct in its statement above cited, still the court completely ignored the fact that $3,000.00 of the amount of the purchase price of said home was loaned to bankrupt by his uncle, about which fact there is no dispute whatever (Tr. 129). Said court also ignored the fact that about $2,000.00 of the money which was expended by bankrupt on household furniture was loaned to him by his mother; and the equity of bankrupt in his home to the extent of $3,000.00 and in his furniture to the extent of $2,000.00 could not under any circumstances be considered tainted by any fraud of any kind. Also, we wish to point out that the fraud of which bankrupt is accused, making misrepresentations in the sale of corporation stock, has never by any court heretofore been considered proper ground for denying the right of exemptions allowed by law.

It will be noted that the trustee's allowance to bankrupt of exempt property included wearing apparel of the estimated value of $300.00 (Tr. 8). It will further be noted that the district court disallowed the bankrupt's exemptions in toto (Tr. 69, par. XX). *Unless this court reverses the judgment of the district court we will have the situation in which the trustee is entitled literally to the "shirt off the back" of the bankrupt.*

C. The only claim made by the trustee that bankrupt was not entitled to his statutory exemptions is based upon the proviso in Sec. 6 of the Chandler Act (11

U.S.C.A. Sec. 24):

> "Provided, however, that no such allowance of exemptions shall be made out of the property which a bankrupt transferred or concealed and which is recovered, or the transfer of which is avoided under this Act for the benefit of the estate, except that where the voided transfer was made by way of security only and the property recovered is in excess of the amount secured thereby, such allowance may be made out of such excess."

It seems to appellant that such proviso does not operate in any way to disallow to bankrupt his statutory exemptions for the following reasons:

First: The transfers of bankrupt's property to the corporation were obtained by duress, and were void and never conveyed any rights to said corporation. (This question will be further discussed under Point VII.)

If said transfers were induced by threats of criminal prosecution and duress, and were unlawfully extorted from bankrupt, such paper transfers did not in fact convey any interest of any kind in said property to said corporation. and did not transfer from bankrupt any rights, either exemption or other rights, in said property. There being no valid transfer of interest in said property, such provision in Sec. 6 of the Chandler Act has no application. We cite the case of *Negin v. Solomon,* 2 Cir., 151 Fed. 2d 112, 114:

> "There is equally little substance in the plaintiff's argument that because the bankrupt re-

> tained power to change his wife as beneficiary, the fund ceased to be exempt. . . . *As well might one argue that if a bankrupt makes a void deed of the homestead to someone outside the family, it ceases to be exempt.*"

Second: Said provision in Section 6 of Bankruptcy Act has no application to facts in this case.

It was the intent of Congress in the enactment of the proviso in question to prevent a bankrupt from claiming exemption in property which he had transferred or concealed with intent to deprive his creditors of their just rights. Here there certainly could not be any such motive on the part of Hansen or any desire to favor the corporation by such transfers. The transfers were coerced from him. I have found no case in which any court (except the district court from which this appeal is taken) has ever denied a bankrupt his exemptions in property transferred because of said proviso, except in cases where the bankrupt has been guilty of attempting to prevent the trustee in bankruptcy from obtaining property to which he was entitled.

Here there was no wrongdoing on the part of bankrupt in executing the transfers; he executed them under compulsion. He was not trying to place his property beyond the reach of his creditors. As soon as he obtained legal advice he filed his petition in bankruptcy for the very purpose of setting aside such transfers, so that all his creditors could share equally

in the property so transferred. It was the bankrupt, not the trustee, who instituted these proceedings to set aside such transfers (Tr. 9-12), and caused to be cited into court the trustee, as well as the receiver, to show cause why such transfers should not be voided.

Third: The nature of such transfers if valid was similar to an assignment for the benefit of creditors.

In the case of *Pilson v. Rodeffer,* 4 Cir., 61 Fed. 2d 976, the court held that when a debtor, being insolvent, conveys all his property to a third party to pay one or more of his creditors to the exclusion of others, such a conveyance will be construed to be an assignment for the benefit of creditors.

Collier, 14th Ed., Vol. 1, p. 842, states:

> "It was the accepted rule prior to 1938 that where a general assignment for the benefit of creditors had been nullified by the subsequent bankruptcy of the assignor within four months of the assignment, the bankrupt might claim his exemptions in the property assigned. . . ."
>
> p. 843: "A reasonable construction of the proviso of par. 6 which has already been discussed would warrant the conclusion that the rule should still prevail, although the language of the proviso is admittedly broad."
>
> p. 844: "It seems only reasonable that a distinction should be made between a bankrupt who has transferred his property for the benefit of his general creditors, which is in a way merely a voluntary application of the bankruptcy theory, and a bankrupt who attempts to con-

> ceal or transfer his property beyond the reach of his creditors or prefer one or more creditors over others. It is not equitable to deprive the bankrupt of his exemptions merely because he had attempted to distribute his property equally among his creditors. . . . In addition to the foregoing, any argument that the trustee should not lose the fruits of his labor is fallacious when applied to the case of the general assignment. . . . Furthermore, under the new and broad jurisdictional provisions of par. 2a (21), the trustee may easily obtain possession and an accounting of the assigned property where the general assignment is supervened by bankruptcy proceedings, and the *propriety of allowing an bankrupt to profit at the expense of a trustee's efforts and labor is, therefore, hardly presented if at all.*"

We believe that the propriety of allowing a bankrupt to profit at the expense of the trustee's efforts is hardly presented at all in the case at bar. It is rather the trustee who is profiting by the bankrupt's efforts. The bankrupt embarked upon an effort to set aside the transfers, and the trustee belatedly joined him. The reason for the rule depriving a bankrupt of his exemptions not being present in this case, the rule itself cannot apply.

Fourth: Section 6 of Bankruptcy Act provides bankrupt may have his exemptions out of property conveyed where transfer made by way of security.

We quote from the last part of Sec. 6:

> "except that, where the voided transfer was made by way of security only and the property recovered is in excess of the amount secured thereby, such (exemption) allowance may be made out of such excess."

The referee found, concluded and decided that the corporation took these conveyances *as security* at a time when it knew Hansen to be insolvent (Tr. 30).

I cite from the referee's Findings of Fact:

> "That Vita-Pakt Associates, Inc., took said conveyances from Hansen and wife *as security.*" (Tr. 42, par. XI)
>
> "The corporation, possessed of these facts, then and there made an election to take the position of a creditor and secure itself by these conveyances." (Tr. 43, par. XIII)

Ernest Jonson, the receiver, testified as follows: (Tr. 141-2)

> "Q. When you say that, you are speaking of the $16,000.00 that he had withdrawn from the corporation?
>
> A. That's right.
>
> Q. And you considered that he owed that to the corporation?
>
> A. Yes."

And Mr. Carney testified that he told Hansen that he had withdrawn about $16,000.00 from the corporation without authority (Tr. 192).

From these facts: That the corporation claimed that

Hansen owed it about $16,000.00, and exacted from Hansen the conveyances in question without in any manner satisfying or cancelling any alleged claim it had against him—for there is no word of testimony of any kind that that was done—the referee properly held that the conveyances were given as security; and there is no word of testimony in the record to warrant or support the finding of the district court that such transfers were not given as security.

Thus, under the specific provisions of such proviso in Sec. 6 of the Bankruptcy Act, the allowance of exemptions may be made out of the excess of the amount secured by such transfers.

Now, the question arises, what is the excess out of which the bankrupt may claim his exemptions? We contend that Hansen did not owe the corporation any amount at all, and that the entire amount of property conveyed constituted the excess of the amount secured, and that Hansen could claim as exempt any of the property transferred. This point will be fully discussed under Point No. VI herein.

Fifth: Said proviso in Section 6 of the Bankruptcy Act is wholly inapplicable because it refers to property "recovered or the transfer of which is avoided under this act for the benefit of the estate."

In the case at bar the property was never recovered because it at all times remained in the possession of the bankrupt until possession was surrendered by him to the trustee; and the paper transfer of said prop-

erty was never avoided for the benefit of the estate, but it was avoided on the petition of the bankrupt and for his benefit, and allowed to the bankrupt as exempt by the referee.

Sixth: Bankruptcy Court should follow decisions of State Court in allowing exemptions.

I quote from Vol. 1, Collier on Bankruptcy, 14th Ed., p. 796-7:

> "It is also well established that in determining the right to exemptions allowed by the states, the state law, as interpreted by the highest judicial tribunal of the state, is controlling, and the decisions of a state court as to whether or not a particular statute is an exemption statute are binding on the bankruptcy court."

We believe the holding of the Supreme Court of the State of Washington in the recent case of *Van Slyke v. Baumgarner,* 177 Wash. 326, 329, 31 P.(2d) 1014, 1015, should be controlling on the question of exemptions in this case.

The facts in that case were: Baumgarner and wife were residing on certain real property. The house was destroyed by fire, and they gave to Van Slyke an assignment of some $2,300.00 of the proceeds of the insurance on said property. Within four months thereafter Baumgarner was adjudicated bankrupt, and claimed as exempt the proceeds of said insurance to the extent of their homestead rights in the real property and exemption rights in the personal property.

By stipulation of the parties the proceeds of the insurance policy were paid to the trustee in bankruptcy without prejudice to the rights of the claimants thereto. The assignee respondent claimed that his assignment did not in law vest in him the legal title to any specific portion of the fund, but created an equitable lien upon the whole; and that he was entitled to payment out of that part of the fund set aside to the bankrupt as exempt. The court declared:

> "We cannot agree with respondent's position, and do not think the authorities cited, general in their application, support his position, under the particular circumstances of this case. Exemption laws are humane in their purpose, and are to be liberally construed in favor of debtors. . . .
>
> "The assignment made by appellants cannot fairly be construed as the pledging of the whole fund to secure payment of respondent's claim. Neither would it be a waiver of their right to claim an exemption, if the right could be waived. The assignment was made before the bankruptcy proceedings, and when appellants had due them from the insurance company over $8,800.00. The bankruptcy proceedings had not then been instituted, and appellants' claim to exemption had not been made. We have not here a case where, after the exemption claim has been made and exempt property set aside and identified, an assignment or charge against it is made. The assignment taken by respondent, in so far as

> the rights of the other creditors were concerned, was an illegal preference, and if no act of the appellants had intervened to stop payment, and the insurance company had paid the money to respondent, he would have been required to turn it over to the trustee, *and appellants would still have their right to their exemptions.* He cannot have a greater right, under the circumstances as they later developed, than he would have had if his claim had been paid by the insurance company. . . .
>
> "They had a right to file the (bankruptcy) petition. Like the exemption laws, the bankruptcy law, while perhaps often abused, is beneficent in its purpose, and when debtors are driven to the wall, it cannot be imputed to them as a wrong that they resort to this means for relief and the opportunity to make a new start in life. . . .
>
> *"Respondent comes into court seeking equitable relief. A court will be slow to grant this relief at the expense of rights secured to appellants by the exemption laws of this state."*

The court then allowed the bankrupt to claim his exemptions out of the proceeds of the insurance policy in spite of the assignment which he had made of its proceeds.

In the case of *In re Dudley* (D.C. Calif.), 72 Fed. Supp. 943, the bankrupt had shortly before his bankruptcy purchased certain property classified by the laws of California as exempt, and Judge Yankwich

allowed him his exemption in said property, stating at p. 946:

> "And where the exemption by state law is absolute and without any limitation as to time, or other restrictive conditions, the bankruptcy court, *bound as it is to follow it,* will apply the same rule, *regardless of any provisions in the bankruptcy law relating to preferences.*"

This decision was affirmed by this court in 166 Fed. 2d 1023, 9 Cir., in the following brief decision:

> *Per Curiam*: "On the grounds and for the reasons stated in its opinion (72 Fed. Supp. 943), the judgment of the district court is affirmed."

The above case illustrates the rule that bankruptcy courts will follow the state laws, and the decisions of the state courts, in allowing the exemptions given by state laws.

The attitude of this court on the allowance of exemptions is clearly indicated in the recent case of *Turnbeaugh v. Santos,* 9 Cir., 146 F. 2d 168, 169. We quote from Judge Denman's opinion:

> "The hearing was conducted by the referee with a complete misapprehension of one of the underlying principles of the homestead law, and one of the findings in a substantial aspect is grossly unfair to appellants. Under the protests of appellants' attorney, appellants were subjected to a gruelling cross-examination as to the husband's past debts existing at the time the wife made the homestead declaration on the

theory that a homestead declarant is acting in fraud of creditors in seeking to establish a homestead. To the contrary, the very purpose of the homestead law is to afford a residence to debtors, which is free from their debts. . . . A homestead is not invalid because the declarant is in debt or declared the homestead to protect it from existing debts. This is the very purpose of the Homestead Laws."

II

The District Court Had No Jurisdiction To Vacate the Referee's Order Approving the Allowance of Bankrupt's Exemptions.

1. The order approving trustee's report on exemptions was *res judicata.*

The Order Approving Trustee's Report on exemptions was filed on October 20, 1948 (Tr. 8). The trustee himself granted to the bankrupt the exemptions claimed by him, and at the specific request of the trustee the referee approved the allowance of said exemptions, after the trustee's report had been on file more than the required ten-day period and no objections had been made thereto. **No petition has ever been filed by anyone to review the order allowing said exemptions.** The time within which any interested party might object to the Trustee's Report on Exemptions was limited to ten days from the date of its filing.

General Order No. 17 in Bankruptcy, as adopted by the Supreme Court of the United States (11 U.S.C.A.

foll. Sec. 53) provides:

> "The trustee shall make report to the court within five days after receiving the notice of his appointment, unless further time is granted by the court, of the articles set off to the bankrupt or debtor by him, according to the provisions of section 47 of the Act, with the estimated value of each article; and any creditor or the bankrupt or debtor may file objections to the determination of the trustee within ten days after the filing of the report, unless further time is granted by the court."

In the case of *In re Krecum,* 7 Cir., 229 F. 711, the court held that the rule that exceptions must be filed to the trustee's report setting aside exempt property within twenty days (the rules in force at that time provided 20 instead of 10 days) is mandatory; and the district court had no discretion and could not permit the filing of objections 21 days after the filing of the report. *If the district court could not even permit filing objections to the report, it must necessarily follow that the district court could not set aside such order without objections being filed.*

In the case of *In re Rabb,* D.C. Tex., 21 F. 2d 254, 256, the court said:

> "General Order 17 of the Supreme Court relating to this matter is mandatory."

In the case of *United States v. Bernstein,* 8 Cir., 16 F. 2d, 233, 236, the trustee had on February 26, 1925, set off to the bankrupt in lieu of homestead the sum

of $500.00. On June 22, 1925, the United States filed exceptions to said report and claimed that the money set off to the bankrupt was not exempt as to the government.

After some discussion of the question as to whether or not the government had to file a claim in bankruptcy, the court stated:

> "It thus appears that whatever its obligation in law may have been, the petitioner submitted to the jurisdiction of the Bankruptcy Court as a litigant under the provision of General Order 17, and subject to the procedure therein prescribed. Its application came too late under the express provisions of the very general order to which it appealed. We may not depart from the procedure laid down by the Supreme Court of which the petitioner has sought voluntarily to avail itself. *The conclusion is irresistible that the report of the referee on this matter of exemption* WAS NO LONGER OPEN TO ATTACK."

The order of the referee allowing exemptions to Hansen had become an order of the district court. In the case of *In re Tinkoff,* 7 Cir., 85 F. 2d 305, Cert. denied, 299 U. S. 609-11, 81 L. Ed. 450, at page 307, the court said:

> "Under the Bankruptcy Act (11 U.S.C.A. sec. 1 *et seq.*) a referee is a quasi-judicial officer who gives judgment or final order upon matters properly submitted to him, subject to review by the district court on the petition of an interested

party. *Adjudications of the referee, if not reviewed within the time and in the manner prescribed. have the force and effect of judgments and orders of the district court.*"

In the case at bar the district court held that the referee should have vacated his Order Approving the Trustee's Report on Exemptions (Tr. 74, par. V). But this court has definitely and clearly held that the referee had no power to set aside such order. When the referee had no power to set aside his order, and when no petition to review said order has ever been filed, then the decision of the district court setting aside such order must be clearly erroneous.

In the case of *In re Faerstein,* 9 Cir., 58 F. 2d 942, the referee had set aside his former order. This court, at page 943, stated:

> "The issue concisely is, Did the referee have the power, after having made and entered formal findings and conclusions, and after the 'turnover order' was issued, to set the same aside, or was the exclusive power vested by law and rule in the United States District Judge to review such order?"

Judge Neterer, then district judge of the court from which this appeal is taken, sitting as a member of this court, stated at page 943 of said opinion:

> "When an order is entered, the referee's power over the order is ended. The remedy is exclusive, and he may not review or change the

order. . .

"That the procedure of review is plainly defined and power limited in the interest of regularity and for the common good is clearly stated by Judge Sawtelle of this court, sitting as district judge, *In re Octave Mining Company,* (D.C.) 212 F. 457, 458, as follows:

'It is manifest that the mode prescribed by General Order 27 is the only manner in which the decisions of the referee may be reviewed.' "

The above case (*In re Faerstein*) was cited and followed by this court in the case of *Grande v. Arizona Wax Paper Company,* 9 Cir., 90 F. 2d 801. In that case no petition for review of the order of a referee was filed within the ten days set by court rule. Petitioner then applied to the district court for an extension of the time within which to file a petition for review. The district court refused to allow any extension of time. This court said at page 805:

"The order of February 18, 1931, allowing these claims has become final. *The referee himself could not set it aside.* (Citing *In re Faerstein* and other cases) In order to attack this allowance it was necessary that a petition for review be filed in the district court within ten days. This was not done, and no appeal to this court lies from the order of the referee except by way of petition to review and an appeal from the order of the district court on the petition."

2. No petition has ever been filed by anyone for the review of the supplemental order of the referee entered on February 11, 1949.

No complaint of any kind was made by the trustee as to the Order Approving Allowance of Exemptions until after the referee had rendered his Memorandum Decision (Tr. 23), over two months after said order had been entered. While the attorneys for the receiver, the trustee and the bankrupt were present in court for the settling of the findings, for the first time the trustee requested the referee to set aside such order. The trustee, apparently conceding that he had no valid grounds upon which to make such request, did not even submit any petition in writing. After the filing of the petitions for review of the referee's order of January 17, 1949, the trustee proposed and the referee signed a Supplemental Order (Tr. 46) denying the trustee's petition to set aside said order approving allowance of exemptions. No petition has ever been filed for the review of said order refusing to set aside the order allowing exemptions.

3. The order approving trustee's report on exemptions was and is *res judicata*, and beyond the power of the District Court to set aside, because:

First: No objection was made to the trustee's report on exemptions within the time allowed by General Order in Bankruptcy No. 17, or at any time thereafter.

Second: No petition to review the Order Approving Trustee's Report on Exemptions has ever been filed.

Third: No petition to review the Supplemental Order refusing to set aside said order allowing exemp-

tions has ever been filed.

Vol. 2, Collier on Bankruptcy, 14th Ed., p. 1488, states:

> "Unless a petition for review is filed with the referee, the district court has no authority to review the action of the referee."

In the case of *In re Madonia,* D.C. Ill., 32 F. Supp. 165, at page 166 the court says:

> "I am of the opinion that the court had discretion within reasonable limits to grant the extension after the expiration of the ten-day period.
>
> "Further, I am of the opinion that the service of the copy is not necessary to give the judge jurisdiction of such matter. *The filing of the petition with the referee is,* but the service of the copy is for the purpose solely of giving notice to the other party that the matter is being taken from the referee to the judge."

In the case of *In re Avoca Silk Company,* D.C. Pa., 241 Fed. 607, 608, the court states:

> "The required petition becomes the foundation of authority and cannot be dispensed with in proceedings to review. When filed the referee is bound to certify; *without it there is no authority to review.*"

Remington on Bankruptcy, 4th Ed., Vol. 2, p. 96, par. 621-654:

> "If a referee has entered an order in a reference made to him and the time for review has

passed, that order is as final and is as much an order of the court as if it had been entered by a judge. A judge cannot disregard it arbitrarily, as seems to be suggested in some of the quotations."

In the case of *In re Realty Foundation Inc.*, 2 Cir., 75 F. 2d 286, the court squarely held that the district judge had power only to review the decision of the referee upon the petition taken by someone having the legal right to ask for the review. We cite from the opinion at page 288, written by Judge Augustus N. Hand:

"Appellee further seeks to sustain the court below on the novel theory that the latter had disposed of the appeal in accordance with a sound discretion. The difficulty with this is that in confirming the sale the referee acted as a judge of the bankruptcy court with power to hear and determine the matter before him, and *the district judge had no power whatever to make orders in the general interest of the creditors, but stood only in the position of an appellate judge who might review the decision of the referee upon a petition taken by someone having a legal interest in the premises.* In our opinion, Certified Associates Inc. had no such interest and could not properly either object to the confirmation of the saleor review the order of confirmation.

"The order of the district court is reversed and the proceeding remanded, with direction to dismiss the petition of Certified Associates Inc.,

to review the order of the referee, and to affirm the latter's order."

The United State Supreme Court in *Bernards v. Johnson,* 314 U. S. 19, 86 L. Ed. 11, in affirming a judgment of this court, 103 F. 2d 567, squarely held that orders of a conciliation commissioner (whose powers are similar to those of a referee in bankruptcy), when no review is sought within the time specified by law, are impregnable to subsequent attack.

This is a long and complicated case, in which litigants attempted to have set aside orders of the conciliation commissioner in cases in which no review was sought within the time limited by law. On page 19, par. 2, the court says:

> **"Assuming the challenged orders of the commissioner and the court were erroneous, were they final, binding and impregnable to subsequent attack, since review or appeal was not sought or taken within the time limited by court rule or law? WE HOLD THAT THEY WERE."**

4. The receiver also is bound by the order allowing bankrupt's exemptions.

In his schedules in bankruptcy Hansen alleged the transfers of his property to the corporation were void because of duress and lack of consideration; and tendered that issue; and claimed statutory exemption in the property so transferred. The corporation was listed

as a creditor whose claim was disputed; the attorneys for the receiver appeared at the first meeting of creditors and cross-examined bankrupt at length. The trustee's report allowing the exemptions was on file for more than the ten-day period fixed by the General Orders in Bankruptcy, before the referee entered his order approving such allowance.

The receiver is bound as absolutely by said order allowing exemptions as was the creditor in the case of *Smalley v. Langenour,* 30 Wash. 307, 70 P. 786. In said case a creditor levied execution on the real property of a judgment debtor. Three days before the execution sale the debtor filed his petition in bankruptcy. The creditor proceeded with said sale and purchased the real property at the sale. About three months later said real property was set aside to bankrupt as exempt. In a suit brought by the creditor to evict bankrupt from the property, *the court held that benkrupt could show that the question had been adjudicated by the bankruptcy court, and that the order of that court setting aside the property as exempt was binding upon the creditor who had previously purchased the property at execution sale.*

Said case was appealed to the U. S. Supreme Court, and its decision is reported in 196 U.S. 93, 49 L. Ed. 400. In affirming the decision of the Washington Supreme Court, it was stated:

"What seems to be complained of is that the

state supreme court accepted the judgment of the Federal Bankruptcy Court as having been rendered in the exercise of the jurisdiction with which it was vested.

"Plaintiffs in error were notified of the proceedings in bankruptcy as provided by the bankruptcy act, and, *if they had desired to contest the claim to exemption, they might have done so,* or could have invoked the supervision and revision of the order by the Circuit Court of Appeals; *but they did not do that, and could not question its validity in the state courts;* unless indeed it were absolutely void, which is not and could not be pretended.

"The bankruptcy court is expressly vested with jurisdiction 'to determine all claims of bankrupts to their exemptions'."

III

The Trustee Is Estopped from Attempting to Deny Bankrupt's Claim to Exemptions After Same Had Been Allowed

The trustee herein on August 31, 1948, filed his Report on Exemptions with the referee, in which he allowed to bankrupt all exemptions claimed. Thereafter on October 20, 1948, no exceptions to said report having been filed, the referee, at the request of the trustee, entered his Order Approving Trustee's Report on Exemptions.

Thereafter on November 2, 1948, the bankrupt in reliance upon the allowance of his exemptions insti-

tuted proceedings in bankruptcy court to have the transfers of his property to the corporation adjudged void (Tr. 9). Said proceedings were burdensome. They involved considerable expense and effort on the part of bankrupt. The trial of the issues consumed several days. All said efforts and money were expended in reliance upon the trustee's allowance of exemptions and the referee's order approving same. The bankrupt and his attorney cooperated with the trustee and aided him to a great extent in the joint efforts of the bankrupt and the trustee to have said transfers adjudged to be void as to both the trustee and the bankrupt.

No court of equity should permit the trustee to use the bankrupt to attain his ends by the allowance of his exemptions, and then when their joint efforts were successful allow such trustee to repudiate his own actions and deprive the bankrupt of exemptions theretofore allowed to him. By the doctrine of judicial estoppel this is not permitted.

In the case of *Axelrod v. Osage Oil & Refining Company,* 8 Cir., 29 F. 2d 712, 729, after discussing the fact that one of the litigants had on previous occasions taken a certain position in the proceedings by its conduct and pleadings, the court said:

> "It seems to us that it is bound by this course of conduct and the position so often taken, and cannot change its position after the Osage Company has relied and acted thereon. The Osage Company and the Continental Company were

both bound by the pleadings in the light of the agreements and understandings, and both were estopped to take positions inconsistent therewith. . . . . ''

''In *Lavis v. Wakelee,* 156 U. S. 680, 689, 15 S. Ct. 555, 558 (39 L. Edn. 578), the court says:

'It may be laid down as a general proposition that, where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him'.''

In the case of *Sinclair Refining Company v. Jenkins Petroleum Process Company,* 1 Cir., 99 F. 2d 9, at page 13, we find:

''The general rule is that one may not to the prejudice of the other party deny any position taken in a prior judicial proceeding between the same parties or their privies involving the same subject matter, if successfully maintained.''

IV

The District Court Had No Jurisdiction To Award Any Funds in the Hands of the Trustee to the Receiver

All of the property of this bankrupt estate was in the possession of the bankrupt at the time of his adjudication in bankruptcy; and the bankruptcy court was the only court having jurisdiction to deal with the conflicting claims thereto. In the receiver's answer to the

show cause petition filed by bankrupt and the trustee, the receiver claimed some kind of equitable lien on said property, and claimed security by reason thereof (Tr. 18). But the receiver has failed utterly to comply with the basic requirements of the Bankruptcy Act, that in order to be entitled to any claim against property of a bankrupt estate in the hands of the bankruptcy court he must file a proof of claim within the time specified by law.

Sec. 57n of the U. S. Bankruptcy Act (11 U. S. C. A., Sec. 93 (n) provides:

> "Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed."

The receiver filed no proof of claim of any kind within the limited six-months period fixed by statute.

This question has been clearly decided in the recent case of *U. S. National Bank v. Chase National Bank,* 331 U. S. 28, 91 L. Ed. 1320, 1324, from which decision we quote:

> "Under these provisions there are several avenues open to a secured creditor of a bankrupt. See 3 Collier, Bankruptcy, 14th Ed. p. 149-157, 255-259. (1) He may disregard the bankruptcy proceeding, decline to file a claim and rely solely upon his security **if that security is properly and solely in his possession. . . . (2) He must file a secured claim, however, if the security is within the jurisdiction of the**

> **bankruptcy court and if he wishes to retain his secured status, inasmuch as that court has exclusive jurisdiction over the liquidation of the security.** *Isaacs v. Hobbs Tie & Timber Company,* 282 U. S. 734, 75 L. Ed. 645, 51 S. Ct. 270, 17 Am. Bankr. Rep. N. S. 273."

The above case holds that a secured creditor *must* file a claim if the property is within the jurisdiction of the bankruptcy court. Here there is no question of the jurisdiction of the bankruptcy court over the property; the trustee sold the property and received the proceeds. The receiver has not filed any claim. *The district court had no right and no jurisdiction to give to the receiver any funds of the bankrupt estate.* No decision could be more clear.

V

The Receiver Waived Any Claim He May Have Had to Any Specific Property of Bankrupt and Elected To Become a Creditor

Carney and Jonson in making their demands upon Hansen to turn over to the corporation all the property which he and his wife owned, including the wife's separate property, did not claim said property as belonging to the corporation, but did claim that Hansen owed the corporation money, and by their threat of criminal prosecution they obtained from Hansen all of his worldly possessions by way of security for the corporation's alleged claim against Hansen (Tr. 142).

The case of *Burgoyne v. McKillip,* 8 Cir., 182 F. 452,

clearly holds that under the facts existing in the case at bar there was an election on the part of the corporation to become a general creditor of Hansen. We quote from pages 453-4 of said decision:

> "When the company took from McKillip what was in substance a mortgage upon his property, it clearly did so as a creditor, and it cannot retain it and at the same time abandon the position then assumed."

In the case at bar the receiver has at all times sought to retain all of the property he secured from Hansen, well knowing that most of said property was not in any way acquired with funds belonging to the corporation or with funds coming from its bank account.

VI

The Finding of the District Court that All Money Derived from the Sale of Capital Stock of Vita-Pakt Associates, Inc. Was Property of the Corporation Is Clearly Erroneous

The total number of shares of capital stock of Vita-Pakt Associates, Inc., was 1,000. Hansen subscribed for 530 shares, and offered to pay for same by turning over to the corporation all equipment and business used in the operation of Vita-Pakt Associates, of which he was then sole owner, subject to the assumption by the corporation of all debts of said business (Tr. 103). The corporation accepted said stock subscription (Tr. 107). The corporation made an allotment of shares of 530 shares to Hansen and 260 shares for sale by the corpora-

tion (Tr. 108). 519 shares were sold for $51,900.00 and 96 shares were donated (Tr. 59). Out of said 615 shares thus disposed of the corporation owned only 260 shares already allotted. The balance of 355 shares must have belonged to Hansen. The money to which the corporation was entitled could not have exceeded $26,000.00. The balance of $25,900.00 must have belonged to Hansen. But the receiver claims, and the district court found, that this money, derived from the sale of Hansen's stock, belonged to the corporation, because of the mere irregularity in not having the stock certificates issued to Hansen.

The referee found as a fact:

> "That of the 615 shares of stock in said corporation which were sold or otherwise disposed of, a substantial though undetermined portion thereof belonged to Hansen. That the funds received from the sale of Hansen's stock, though deposited in the account of Vita-Pakt Associates, Inc., belonged to and remained the property of Hansen (Tr. 42-43).

How can the finding of the district court be other than clearly erroneous?

The sum of $5,897.00 which Hansen withdrew from the corporation bank account and used in the purchase of his home and car was his own money, as he had deposited in said account a much larger amount of his own money. There can be no tracing of trust funds un-

til a trust is established. No trust was here established because the money used by Hansen was his own money, derived from the sale of his own stock.

The inconsistency of the court's findings is shown by its order that the finding that Hansen had withdrawn $16,157.71 in corporation funds and appropriated same to his personal use

> "shall not be res adjudicata as to any claim filed by the receiver." (Tr. 61)

If that finding were true, then it should be an adjudication as to any claim filed by the receiver. The receiver and the trustee were both before the court in this proceeding. The court should not have made any finding against the interests of the bankrupt, which would not be binding upon all parties to the proceeding.

VII

The Finding of Fact that the Transfers by Hansen to the Corporation Were Voluntary and Not Obtained by Threat of Criminal Prosecution Is Clearly Erroneous

We believe the record proves conclusively that such transfers were obtained by duress and threat of criminal prosecution. Hansen testified that he executed said transfers because he thought he would have to go to jail if he didn't (Tr. 89-92).

Mrs. Hansen testified as follows (Tr. 172):

> "Q. What was your purpose in signing these papers?

A. Naturally, for the purpose of protecting him so he wouldn't have to go to jail. . . .
Q. Was that your only purpose in signing them?
A. That was the only purpose."

Carney admitted he did tell Hansen:

"that he had failed to get a permit to sell stock and had committed a gross misdemeanor by selling stock without such a permit."

and

"Hansen brought up the subject of whether or not the stockholders were going to prosecute, and I did say that probably the stockholders would feel more kindly toward him if he turned over the property to the corporation." (Tr. 192)

Yet in the face of the above uncontroverted testimony, the district court found that said transfers were made voluntarily. Clearly, such finding is erroneous.

In the case of *State v. Richards,* 97 Wash. 587, 167 P. 47,, defendant was charged with blackmail. He had accused one Thompson of assault, blackmail, larceny and other crimes in order to compel him to execute a certain lease of real estate.

Defendant contended that if he believed he was justly entitled to that which he demanded, such belief was a defense.

At page 589 (p. 48 of Pac. Reporter) the court said:

"It must be admitted that to commit the crime charged, there must be an intent to extort or gain,

> but that does not mean that one can by employment of the means used in this instance, compel another to bestow upon him that which he thinks or believes he is entitled to receive. . . . In this sense, one can commit this crime though he is of the opinion that the money thus sought is actually due him. The law does not countenance forceful and unlawful collection even of just debts, and when one uses the methods set forth in this statute to obtain money or property, he commits the crime defined in the statute, irrespective of the belief that is so doing he is only attempting to obtain that which he is entitled to receive."

In the case of *Bank of Fredericksburg v. Wendel,* 11 S. W. 2d 341, 342, the bank's officers threatened to prosecute plaintiff's husband (as was done in the case at bar), unless the wife conveyed certain property to the bank.

The court said:

> "The question is: Did these threats actually induce the act now sought to be nullified?"

We quote from the decision in the case of *Baker v. Morton,* 79 U. S. 150, 20 L. Ed. 262, 264:

> "Where a party enters into a contract for fear of loss of life or for fear of loss of limb or fear of mayhem, *or for fear of imprisonment* the contract is as clearly void as when it was procured by duress of imprisonment."

In the case of *Kronmeyer v. Buck,* 101 N. E. 935, a

lawyer accused a man of embezzlement and by threats of criminal prosecution obtained the conveyance of property, and obtained from a sister of the victim the execution of a promissory note.

We quote from the opinion, par. (1), p. 938:

> "We have no hesitation whatever in holding that the execution of the note by Mrs. Stachle was procured by duress. She was an innocent third party. There can be no pretense that she was indebted to Buck in any amount. . . . She signed the note to keep her brother from going to jail, and under the belief that if she signed it he would be saved from imprisonment and prosecution. . . . While no promise of immunity was expressly made, it is perfectly clear that both she and Kronmeyer were influenced by the understanding, which was clearly to be implied, that if the matter was adjusted satisfactorily Kronmeyer would not have to go to jail or be prosecuted."

The holding of the above case applies exactly to the matter of the conveyances by Mrs. Hansen, which conveyances under that holding are absolutely void because obtained under duress.

CONCLUSION

We respectfully submit:

That the district court was guilty of clear error in failing to affirm the order of the referee in bankruptcy.

That the award of exemptions to the bankrupt was res judicata, and it was beyond the power of the district court to set aside such award.

That appellant was clearly entitled to the exemptions provided by the laws of the State of Washington, and awarded to him by the trustee and the referee in bankruptcy.

That the receiver was not entitled to the award of any money in the hands of the trustee.

Respectfully submitted,

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